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No. 10-100

IN THE

Supreme Court of the United States

ROBERT L. BERGBAUER and MARIE T. BERGBAUER,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Does an agreement by parties to a sale that income to the seller shall be immediately taxable, despite the lack of control by the seller of the income and a risk that the income will be forfeited, supersede provisions of the Internal Revenue Code and regulations that mandate taxation only when a taxpayer comes into control of income and any risk of forfeiture of that income has lapsed?

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Robert L. Bergbauer and Marie T. Bergbauer respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fourth Circuit.

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-27a) is reported at 602 F.3d 569.

The district court's memorandum opinion granting Respondent's motion for summary judgment and denying Petitioner's motion for summary judgment (Pet. App. 28a - 55a) is unreported but available electronically at 2008 WL 3906784. The accompanying order (Pet. App. 56a - 57a) is unreported.

JURISDICTION

Petitioners seek review of a final decision of the court of appeals entered on April 16, 2010. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

This case involves 26 U.S.C. § 451(a), 26 C.F.R. § 451-1(a), 26 C.F.R. § 451-2(a), and 26 C.F.R. § 1.1060-1(e). These provisions are lengthy and are therefore set out in Appendix D in accordance with Supreme Court Rule 14.1(f).

STATEMENT OF THE CASE

This case presents an important question concerning the ability of parties to a sale to determine for themselves, in derogation of the provisions of the Internal Revenue Code (Code) and the regulations thereunder, when the

income to the sellers should be taxable. The Code and regulations dictate that income for a cash basis taxpayer should be taxable only when that income is actually or constructively received. In disregard of these provisions, the Fourth Circuit – and several other courts that have considered the same transaction[1] – concluded that the income from the sale in question should be taxable upon the closing of the sale solely because the parties intended that the sale should be then taxable despite the absence of actual or constructive receipt of the income at that time.

In its holding, the Fourth Circuit ignored relevant decisions of this Court. These decisions have consistently held that "the propriety of a [tax treatment] does not turn upon general equitable considerations," such as the intentions of the parties. *Comm'r v. Nat'l Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134, 148 (1974). "Rather, 'it depends upon legislative grace; and only as there is clear provision therefor can any particular [tax treatment] be allowed.'" *Id.* at 149 (quoting *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440 (1934)).

Specifically, in holding that petitioners Marie and Robert Bergbauer were immediately taxable upon income credited to Robert Bergbauer but not made available to him and subject to a substantial risk of its subsequent forfeiture, the Fourth Circuit declined to give effect to a tax principle enunciated in a leading decision of this Court later reflected in section 1.451-2(a) of the Treasury

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1. *United States v. Fletcher*, 562 F.3d 839 (7th Cir. 2009);*United States v. Fort*, 2010 WL 2104671 (N.D. Ga. 2010); *United States v. Nackel*, 686 F. Supp. 2d 1008 (C.D. Cal. 2009); *United States v. Berry*, 2008 WL 4526178 (D.N.H. 2008); *United States v. Culp*, 2006 U.S. Dist. LEXIS 95030 (M.D. Tenn. 2006).

Regulations that a taxpayer cannot be taxed on income that the taxpayer has "no right . . . to demand . . . [and] which [the taxpayer] might never receive." *North Am. Oil Consol. v. Burnet*, 286 U.S. 417, 423 (1932); 26 CFR 1.451-2(a) ("income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions"). If allowed to stand, this holding would invite parties to transactions giving rise to taxable income to determine on the basis of their own financial circumstances and not upon application of the Code and regulations when that income is taxable to the intended recipient of the income with likely substantial cost to the nation's tax revenues and confusion in the administration of the tax laws.

A. Facts of the Transaction

On May 23, 2000, Cap Gemini, S.A. (Cap Gemini) acquired the consulting business of Ernst & Young LLP (Ernst & Young). Pet. App. 29a. At the time of the acquisition, Robert Bergbauer was an Ernst & Young consulting partner situated in the United States. Upon the closing of the transaction (Closing), Robert Bergbauer became an employee of a Cap Gemini affiliate, Cap Gemini Ernst & Young (CGE&Y), established to take over the consulting business. Pet. App. 29a.

The transaction documents consisted principally of a Master Agreement, a Consulting Party Transaction Agreement (CPTA), and an agreement establishing for each selling shareholder the terms for operation of a restricted brokerage account (Special Account Instruction Agreement). Pet. App. 6a. Pursuant to these documents (Transaction Documents), Robert Bergbauer and the

other selling partners were credited with shares of stock in Cap Gemini in return for their interests in Ernst & Young.

The Transaction Documents provided that only twenty-five percent (25%) of the shares of stock that each selling partner was ultimately to receive was immediately salable by the partners. The remaining seventy-five percent (75%) of the shares were deposited by Cap Gemini at the Closing directly into the restricted accounts set up by the Special Account Instruction Agreement (Restricted Accounts) to be released ratably to the selling partners in the year following the Closing and the subsequent four years. Pet. App. 3a - 4a.

The Special Account Instruction Agreement gave control over the Restricted Accounts to an official of CGE&Y. Except for credit to the selling partners for dividends distributed on the shares in the Restricted Accounts and except for a right to instruct the CGE&Y official as to the voting of the shares, the selling partners enjoyed no benefit from the shares in the Restricted Accounts. As the District Court described the provisions of the Transaction Documents related to the shares in the Restricted Accounts:

> Specifically, under the CPTA, Bergbauer could not "directly or indirectly, sell assign, transfer, pledge, grant any option with respect to or otherwise dispose of any in interest in" Cap Gemini Shares, except in periodic offerings organized by Cap Gemini for a period of four years and 300 days after the closing. Second, Bergbauer granted Cap Gemini exclusive authority to invest, transfer and release the

> shares in his Merrill Lynch Restricted Account during the time period. Third, under the liquidated damages clause of the CPTA, Bergbauer agreed that he would forfeit some or all of the Cap Gemini shares if he breached provisions of the employment agreement with CGE & Y, voluntarily ended his employment or was terminated "for cause" or "poor performance."

Pet. App. 48a - 49a (citations to record omitted).

As to the substantiality of the risk that Robert Bergbauer might forfeit shares in his Restricted Account, any voluntary resignation from employment was under Robert Bergbauer's control. He could also regulate breaches of his employment agreement which contained provisions related to non-competition and the maintenance of the confidentiality of CGE&Y information. Pet. App. 6a. The Transaction Documents did not define the term "cause" (Pet. App. 49a n.4), but Robert Bergbauer could be expected to have some control over whether he might give "cause" for his termination and forfeiture of shares.

The same cannot be said for any termination of Robert Bergbauer's employment for "poor performance." While the term was not defined in the transaction documents (Pet. App. 49a n.4), the meaning was given substance in a summary of the transaction entitled "Partner Information Document" (PID) distributed to the selling partners by Ernst & Young on March 2, 2000, about seven weeks prior to the Closing. Pet. App. 30a. The PID construed "poor performance"

to mean "any reason other than for cause." Joint Appendix, 4th Cir., at A283. Robert Bergbauer accordingly faced dismissal and the forfeiture of shares in the Restricted Account whenever CGE&Y chose to terminate his employment, whether or not the precipitating circumstances were ones over which Robert Bergbauer could have any influence. [2]

B. Petitioners' Tax Returns

Notwithstanding Robert Bergbauer's lack of beneficial enjoyment of the shares in the Restricted Account and the substantial risk that Robert Bergbauer would forfeit shares, the Bergbauers' joint tax return for the year 2000, prepared for them by Ernst & Young, included the full value of the shares credited to Robert Bergbauer at the Closing. Pet. App. 37a. The Transaction Documents themselves contained no language dictating when the proceeds were to be taxable to the selling partners. Pet. App. 6a. The PID, however, in language that the Court of Appeals found evinced the intent of the parties, recited that, "For all . . . partners . . . [t]he gain on the sale of the

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2. The case of *Palowitch v. Cap Gemini Ernst*, 6 Misc.3d 1001(A), 2004 WL 2964426 (N.Y. Sup. Ct. 2004) evidences the breadth of the discretion to declare a forfeiture claimed by Cap Gemini. In that case, a partner sued Cap Gemini in connection with his dismissal and the confiscation of all of the shares in his Restricted Account. According to the court decision in the case upholding an arbitration award in the partner's favor, Cap Gemini terminated the partner's employment "without stating a reason" and defended its conduct on the basis that it was authorized to do so under the "poor performance" termination provision of the transaction documents. 2004 WL 2964426 at *1.

distributed [CGE&Y] shares is reportable on Schedule D of your U.S. federal income tax return for 2000." Pet. App. 5a. The return also reflected a Form 1099-B issued to Robert Bergbauer by Cap Gemini that showed the full value being distributed at the Closing. Pet. App. 37a.

On or about June 3, 2003, the Bergbauers filed an amended federal income tax return for the 2000 tax year. Pet. App. 37a - 38a. The Bergbauers' amended return reported that Robert Bergbauer had received in 2000 only the shares that had not been deposited into the Restricted Account. Pet. App. 9a. In their amended return, the Bergbauers explained that they were not otherwise taxable on the shares due to the "lack of control over the remaining Seventy-Five (75%) of the stock in the trust." Pet. App. 9a.

The Internal Revenue Service (IRS) initially reviewed and accepted the amended return and provided a refund to the Bergbauers for the taxes paid on the shares in the Restricted Account. Pet. App. 9a. Subsequently, the IRS changed its position and brought a civil action in the United States District Court for the District of Maryland against the Bergbauers under section 7405 of the Code seeking return of the refunded amount. Pet. App. 9a - 10a. Following discovery, the parties filed cross motions for summary judgment. Pet. App. 10a.

C. District Court Decision

The District Court awarded summary judgment to the Government and denied summary judgment to the Bergbauers. Pet. App. 55a. The District Court evaluated the taxability of the shares according to what it described as a "two-pronged, 'economic reality' test." Pet. App. 54a. This test derives from the Fourth Circuit decision in *Gen. Ins. Agency Inc. v. Comm'r*, 401 F.2d 324 (4th Cir. 1968), and "examines the tax consequences contemplated by the parties and the economic substance of the agreement." Pet. App. 43a. The District Court held that, based upon the "extrinsic evidence" of the language in the PID, "the parties original intent was for the [selling partners] to be immediately taxable on the entirety of the shares they received at the transaction's closing on May 23, 2000." Pet. App. 53a. Since, according to the District Court, such taxation also furthered "real economic purposes," the Bergbauers were obligated to report their income in accordance with the parties' intention. Pet. App. 54a.

The District Court made mention of section 451 of the Code and the regulations thereunder, noting in a footnote that, in accordance with section 1.451-2(a) of the Treasury Regulations, "If the taxpayer's ability to control the account 'is subject to substantial limitations or restrictions,' then the income is not deemed to have been constructively received." Pet. App. 48a n.3. The District Court cited these provisions only to establish, however, that the transaction documents, which contained such limitations or restrictions, did not reveal the intent of the parties. Pet. App. 49a. In other words, the District Court viewed the Code only as a backdrop

for the parties' decision as to when the shares should be taxable. In the view of the District Court, the fact that the parties may have included impediments to the sellers' realization of any value from the shares placed in the Restricted Account merely suggested that the parties may have intended that the shares not be taxable when placed in the Account. The Code figured in the District Court's calculus simply as a device to divine party intent and not as an independent basis for governing when the shares might be taxable.

D. Court of Appeals Decision

The Bergbauers noted a timely appeal from the decision of the District Court. Pet. App. 11a. Following oral argument, the Fourth Circuit of Appeals affirmed the decision of the District Court. Pet. App. 2a. In reaching its decision, the Court of Appeals gave fuller consideration to the operation of the Code and regulations.[3] Like the District Court, however, the Court of Appeals chose to disregard that operation when the results might conflict with the intention of the parties. The Court of Appeals explicitly stated, "If Robert Bergbauer had received the Cap Gemini stock in the absence of an agreement, but subject to the forfeiture

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3. In its decision, the Court of Appeals dismissed an argument allegedly made by the Bergbauers premised on the applicability of section 83 of the Code. Pet. App. 24a. The Bergbauers did not argue that section 83 of the Code applied by its terms but rather that, since Robert Bergbauer received his shares in order to protect the continued availability to CGE&Y of his services, the constructive receipt rules of section 83 of the Code having to do with the taxability of property received for services could prove instructive.

and restricted transfer provisions [of the Code and regulations], his timing argument for the year of income recognition might have more credence." Pet. App. 25a. Giving primacy to the parties' agreement over the contravening dictates of the Code, the Court of Appeals went on to state, "As the legion of caselaw set forth above clearly illustrates, a taxpayer's choice of tax treatment under a binding contract is not an optional commitment." Pet. App. 25a.

The Court of Appeals decision does identify a number of decisions standing for the proposition that an agreement between parties to a transaction as to the tax treatment of the transaction can bind the parties and, effectively, the IRS. But not a single one of these cases, nor any other cases that the Court of Appeals might have adduced, has held that an agreement of the parties can bind the parties and the IRS to a result contrary to that dictated by the Code and regulations. Indeed, the one case cited by the Court of Appeals which addressed the instant issue, the time when income is taxable, reached the result urged here by Petitioners that language in an agreement reflecting an intention of the parties must be disregarded if that language posits a date for taxability other than the date of actual receipt. In that case, *Signet Banking Corp. v. Comm'r*, 118 F.3d 239 (4th Cir. 1997), the court determined that a credit card charge identified in the card issuer agreement as an "annual membership" fee was, notwithstanding the label, a one time flat exaction and, despite the apparent contrary intention of the parties, was income to the issuer in the year paid. *Id.* at 241. In language highly instructive here, the court held, "For obvious reasons, a taxpayer's classification of its own transaction cannot determine the appropriate tax treatment." *Id.* at 242.

E. Application of the Provisions of the Code and Regulations

The Code gives no discretion or latitude to parties to determine *when* income shall be taxable. The Code specifically provides the "[t]he amount of any item of gross income shall be included in the gross income *for the taxable year in which received by the taxpayer.*" 26 U.S.C. § 451(a) (emphasis added). Receipt for this purpose can be actual receipt or constructive receipt. 26 C.F.R. § 1.451-1(a) ("Gains, profits, and income are to be included in gross income for the taxable year in which they are actually or constructively received by the taxpayer.").

It is clear that Robert Bergbauer did not *actually* receive for tax purposes the shares placed in the Restricted Account at the Closing. To be *actually* received, income must be "actually reduced to a taxpayer's possession." 26 C.F.R. § 1.451-2(a). The shares did not come within his actual possession. Rather, they were deposited directly by Cap Gemini at the Closing into the Restricted Account and could not be transferred by Robert Bergbauer except as they were released upon the lapse of the restrictions on the forfeiture of the shares. In the absence of full dominion over the shares, Robert Bergbauer could not actually receive them for tax purposes. *See, e.g., Mac Sim Bar Paper Co. v Comm'r*, 1941 WL 10335 (B.T.A. 1941) (seller of business did not actually receive, and was not taxable on the value of, shares placed with escrow agent because he did not exercise "dominion and control" over them); *see also, to similar effect, Goetze Gasket & Packing Co., Inc. v. Comm'r*, 24 T.C. 249, 255 (1955); *Hall v. Comm'r*,

15 T.C. 195, 200 (1950), *aff'd.*, 194 F.2d 538 (9th Cir. 1952); *Int'l Trading Co. v. Comm'r*, T.C. Mem. 1958-104, 1958 WL 877, *aff'd on other grounds*, 275 F.2d 578 (7th Cir. 1960); *Appeal of Schneider*, 3 B.T.A. 920, 923, 1926 WL 865 (1926) (holding that taxpayers were not taxable on shares placed in escrow to secure future services despite the enjoyment by the taxpayers of full dividend and voting rights).

Similarly, Robert Bergbauer did not constructively receive the shares that were placed into the Restricted Account. Pursuant to the Treasury Regulations, income is *constructively* received when it is "credited to [the taxpayer's] account, set apart for him, or otherwise made available to him so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions." 26 C.F.R. § 1.451-2(a).

The regulations go on to cite as an example of the absence of constructive receipt a circumstance substantially indistinguishable from the instant one. "[I]f a corporation credits its employees with bonus stock, but the stock is not available to such employees until some future date, the mere crediting on the books of the corporation does not constitute receipt." *Id.* The stock deposited in the Restricted Account was issued in Robert Bergbauer's name, i.e., it was credited to Robert Bergbauer on the Cap Gemini books. Yet the stock, in order to secure to CGE&Y the value of Robert Bergbauer's services, was not made *available* to Robert

Bergbauer until the years following the Closing when certain conditions beyond Robert Bergbauer's control, including his continued employment, had been met.

No agreement or intention by a taxpayer to accelerate the time of taxation as otherwise determined under the Code and regulations can be effective. *See, e.g., Weil v. Comm'r*, 173 F.2d 805, 806 (2d Cir.), *cert. denied*, 338 U.S. 821 (1949) (sustaining a challenge by the Government to the reporting by executors of fees in a year prior to when dictated by the rules of constructive receipt); *see also Ware v. Comm'r*, 906 F.2d 62, 65 (2d Cir. 1990) (law firm not entitled to recognize as income fee held in escrow account subject to dispute with client until the dispute resolved); *cf. Williams v. United States*, 219 F.2d 523, 527 (5th Cir. 1955) (the placement of the proceeds of a sale of timber in an escrow account to defer their taxation to the sellers was ineffective when the sellers faced no meaningful risk of not ultimately obtaining the proceeds, with the court finding that "the self-imposed limitation of the escrow device did not in fact and in law change the situation so as to make the funds any less available to [the sellers], and constructively received by them").

F. Other Decisions Passing upon Transaction

The final decisions in the other cases addressing the tax consequences to selling partners of the instant transaction share the shortcoming of the Fourth Circuit decision in either disregarding or minimizing the impact of the Code and regulations in favor of giving decisive effect to the perceived intention of the parties that the full proceeds to the partners be taxable at the Closing.

See United States v. Fletcher, 562 F.3d at 844; *United States v. Fort*, 2010 WL 2104671 at *2; *United States v. Nackel*, 686 F.Supp.2d at 1023; *United States v. Berry*, 2008 WL 4526178 at *6; *United States v. Culp*, 2006 U.S. Dist. LEXIS 95030 at *63.

Arguably the most complete discussion of the Code and regulations appears in *Fort* in which the court, after a reference to the relevant statutory provisions, concludes that they do not bar immediate taxation because the selling partner "still exercised substantial control over all of the shares in 2000." *United States v. Fort*, 2010 WL 2104671 at *2. Apart from the ability of the selling partners to receive dividends and to direct how the shares were voted, the bases for this finding are unavailing. An assertion that the selling partners "alone stood to gain or lose money based on the stock's performance" is incorrect in that the benefit of any appreciation or depreciation in the value of the forfeited shares would redound to Cap Gemini, and this fact is, in any event, a circumstance of limited significance in determining control in view of the inability of the selling partners to realize any such appreciation or depreciation during the time the shares were in the Restricted Accounts. The other contentions in *Fort*, that the selling partners agreed to the restrictions or limitations and agreed to a discount from market in the value of any shares that became taxable, simply avoid the question of the effect of the restrictions and limitations, the question that is central to the analysis contemplated by section 451 and the regulations thereunder.[4]

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4. The decision also cites three early cases that were first mentioned by the court in *Fletcher* for the proposition that stock held in escrow to secure a party's performance may yet be

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REASONS FOR GRANTING THE PETITION

The Court of Appeals decision gives primacy to the intentions of the parties to a sale transaction as to the timing of the taxation of the proceeds of the sale over the contrary dictates of the Code and regulations. The Court of Appeals may have had laudable motives in so deciding. As it asserted, "This precept [of binding parties to an agreement to the tax treatment they elected] not only maintains the vital public policy of enforcing otherwise valid contracts, but also assures the reliability of agreed tax consequences to the public fisc." Pet. App. 16a. Regrettably, the Court's decision not only fails to further these compelling goals, but, if allowed to stand, would eviscerate decisions of this Court by elevating form over substance and by permitting taxpayers to determine the tax consequences of transactions without regard to the contrary dictates of the Code and regulations.

First, it should be noted that the Court of Appeals decision in no way advances the sanctity of contracts or protects against deleterious consequences to the public treasury. As for the importance of binding parties to

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considered to have been received when first deposited. *United States v. Fort*, 2010 WL 2104671 at *2; *see, also, United States v. Fletcher*, 562 F.3d at 844. Not only are the cases readily distinguishable on their facts, but any relevant learning from those cases has been superseded by more recent decisions treating facts more similar to the instant ones. *See Goetze Gasket & Packing Co., Inc. v. Comm'r*, 24 T.C. at 255; *Hall v. Comm'r*, 15 T.C. at 200; *Int'l Trading Co. v. Comm'r*, T.C. Mem. 1958-104, 1958 WL 877.

their bargains, the Court of Appeals position might have merit if this case represented a dispute as to the enforcement of a provision of an agreement resolving a matter within the province of the parties to determine. The timing of taxation of the proceeds of a sale, however, is squarely addressed by the Code and regulations. *See* 26 U.S.C. § 451(a); 26 C.F.R. §§ 1.451-1(a) and 1.451-2(a). The Bergbauers are not seeking to alter a provision of the Cap Gemini agreement as much as to nullify a provision that contradicts the Code.

As to protecting the public fisc, the best strategy almost certainly lies in having a code of tax laws that cannot be disregarded when it might suit taxpayers financially to do so. The "whipsaw" effect of inconsistent tax filings, an evil that the Court of Appeals ostensibly sought to avoid (Pet. App. 17a), cannot be prevented by leaving to the parties a decision as to the tax consequences that the IRS has no way of detecting without an audit of each taxpayer. In the absence of a tax provision requiring disclosure by the parties with their returns of an agreed date for reporting income,[5] the IRS is no better off in deferring to a decision of the parties than in relying upon the voluntary compliance by the parties with the clear standards of taxation embodied in section 451 of the Code and the regulations thereunder.

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5. As an example of such a disclosure obligation, section 1.1060-1(e) of the Treasury Regulations requires that the seller and purchaser of a group of assets making up a trade or business file an information return (Form 8594) showing the agreed allocation of the purchase price among the assets when goodwill or going concern value attaches or could attach to the assets. 26 C.F.R. § 1.1060-1(e).

Second, the decision of the Court of Appeals, if not overturned, would undermine two principles uniformly applied by this Court in interpreting the nation's tax laws – the importance of substance over form in determining the tax consequence of a transaction and the inviolability of the provisions of the Code against challenges by taxpayers who might seek a different outcome than the Code prescribes.

The Court of Appeals made no secret of its elevation of the form of the agreement – the expression of intent that all of the shares credited to the selling partners be taxable at the Closing – over the substance of the transaction which denied any significant benefit from the shares to the partners until the condition of their continued employment had been met and the attendant risk of forfeiture of the shares had lapsed. As the Court noted,

> To put it plainly, we have bound taxpayers to the 'form' of their transaction when they attempt to recharacterize an otherwise valid agreement bargained for in good faith. We have also refused to entertain arguments that the 'substance' of their transaction triggers different tax consequences.

Pet. App. 16a (citations and internal quotation marks omitted). Yet it is a salient feature of this Court's tax jurisprudence that the characterizations that taxpayers place on their own transactions cannot dictate the tax results. "To permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities, would seriously impair the effective

administration of the tax policies of Congress." *Comm'r v. Court Holding Co.*, 324 U.S. 331, 334 (1945) (holding that, notwithstanding language of a sale agreement to the contrary, the seller of an apartment house was a corporation and not its shareholders).

The substance of the Cap Gemini transaction was that Robert Bergbauer and the other selling shareholders received limited immediate value from the shares deposited in the Restricted Account as long as they could not control those shares and bore a substantial risk that the shares would be forfeited due to circumstances, a termination by CGE&Y for "poor performance," that was beyond their control. In the face of such substantial restrictions and limitations upon their enjoyment of the shares, they could not actually or constructively receive the shares until those restrictions and limitations lapsed. 26 C.F.R. § 1.451-2(a); *see North Am. Oil Consol. v. Burnet*, 286 U.S. at 423 (holding that there was "no constructive receipt" by an oil company of profits from company land operated by a receiver until "there was a right in the company to demand that the receiver pay over the money"); *see also Comm'r v. Indianapolis Power & Light Co.*, 493 U.S. 203, 209 (1990) (concluding that, notwithstanding some economic benefit derived by a utility company from customer deposits and the lack of segregation of those deposits from the company's general funds, the deposits were not income to the company, with this Court stating, "The key [to whether a taxpayer has 'complete dominion' over a given sum and is taxable on that sum] is whether the taxpayer has some guarantee that he will be allowed to keep the money.").

The Court of Appeals decision also would undermine the administration of the tax laws in making their operation subservient to the wishes of taxpayers as expressed in their agreements. This Court wisely cautioned against any such substitution of fairness or expedience for the considered judgment of the Congress. What this Court recited of tax deductions, that they do "not turn upon general equitable considerations . . . but rather . . . upon legislative grace," *Comm'r v. Nat'l Alfalfa Dehydrating & Milling Co.*, 417 U.S. at 148, applies to section 451 of the Code and the regulations thereunder that dictate when income becomes taxable to its recipients. The latter are no more susceptible to alteration by agreement or the will of a taxpayer than the former.

CONCLUSION

In order to sustain the integrity of the provisions of the Code and the regulations thereunder in determining the timing of the taxation of income against formalisms or contrary dictates in the agreements of taxpayers, this petition for certiorari should be granted.

Respectfully submitted,

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APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT DECIDED APRIL 16, 2010

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 08-2054

UNITED STATES OF AMERICA,

Plaintiff-Appellee,

v.

ROBERT L. BERGBAUER;
MARIE T. BERGBAUER,

Defendants-Appellants.

Appeal from the United States District Court
for the District of Maryland, at Baltimore.
Richard D. Bennett, District Judge.
(1:05-cv-02132-RDB)

Argued: January 28, 2010

Decided: April 16, 2010

Before MOTZ, SHEDD, and AGEE, Circuit Judges.

Affirmed by published opinion. Judge Agee wrote the opinion, in which Judge Motz and Judge Shedd joined.

Appendix A

OPINION

AGEE, Circuit Judge:

Robert and Marie Bergbauer appeal from the grant of summary judgment to the Government establishing their federal income tax liability. The district court held that Robert Bergbauer's sale of his interest in a subsidiary of Ernst & Young LLP ("Ernst & Young") was a fully taxable event in the year 2000. For the reasons set forth below, we affirm the judgment of the district court.

I.

A.

In 1999, Ernst & Young LLP ("Ernst & Young") entered into a letter of intent to sell its consulting business to Cap Gemini, S.A. ("Cap Gemini"). The parties agreed that Ernst & Young would transfer the assets of the consulting division of its business to a newly-formed subsidiary, Cap Gemini Ernst & Young US LLC ("CGE&Y"), and thereafter distribute membership interests in CGE&Y primarily to those partners in Ernst & Young, like Robert Bergbauer, who worked in the consulting division ("the consulting partners"). Immediately following the distribution, Ernst & Young and the consulting partners would sell their CGE&Y membership interests to Cap Gemini in exchange for Cap Gemini common stock. As a result, Cap Gemini would own all the equity interests of CGE&Y

and operate the former Ernst & Young consulting practice through that entity.[1]

Ernst & Young distributed a Partner Information Document ("PID") to the consulting partners which described the proposed transaction.[2] The PID indicated that the exchange of CGE&Y membership interests for Cap Gemini stock would be structured as a "taxable capital gains transaction," in which the "partners are treated as though they receive all of the gain and are taxed on it." J.A. 285. The PID also provided that "[a]ll partners will vest in their shares immediately upon closing. However, the shares . . . will be subject to forfeiture" under certain circumstances. J.A. 280. The Cap Gemini shares received would not be directly distributed to the consulting partners, but would "be held in an individual account in an institution such as . . . Merrill Lynch and [would] be subject to resale restrictions." J.A. 278.

Twenty-five percent of each consulting partner's Cap Gemini shares would be released for sale shortly after the transaction closed, so the consulting partner could cover the 2000 tax liability incurred as a result of

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1 The consulting partners would then sever their relationship with Ernst & Young by divesting their partnership interests in Ernst & Young, cashing out their capital accounts, and becoming employees of CGE&Y.

2. The PID was not a contract document to be executed by the parties, but an informational document somewhat akin to a prospectus for security investments.

recognizing the receipt of all the Cap Gemini stock as income that year. The remaining seventy-five percent of a partner's shares would be held in a restricted brokerage account for that partner and could be "monetized," that is sold, in installments of up to fifteen percent of the partners' shares on each of the next five anniversary dates of the sale. A consulting partner could not "directly or indirectly, sell, assign, transfer, pledge, [or] grant any option with respect to or otherwise dispose of any interest" in non-monetized shares. J.A. 785. While non-monetized shares were held in the restricted brokerage accounts, those shares were subject to forfeiture "for breach of [partners'] individual Cap Gemini agreements, early departures or termination for cause." J.A. 280. Upon monetization all restrictions on those shares lapsed.

Of particular import for the timing-of-income issue in the case at bar, the PID stated:

> The fair market value of the stock received that cannot be sold immediately will be calculated at 95 percent of the closing price of Cap Gemini stock on the day of the exchange for [CGE&Y] shares. This discount will slightly reduce tax due on the Cap Gemini shares received at closing. . . . Ernst & Young, its partners, and Cap Gemini will treat valuation and related issues consistently for [U.S.] federal income tax purposes. . . .

> For all . . . partners . . . [t]he gain on the sale of the distributed [CGE&Y] shares is reportable on Schedule D of your U.S. federal income tax return for 2000.

J.A. 285-86.

The consulting partners, including Robert Bergbauer, had the opportunity to review the PID before they met on March 7-8, 2000 to discuss and vote on the proposed transaction. During its presentation of the proposed transaction, Ernst & Young's management answered questions regarding the tax implications of the receipt of Cap Gemini stock, particularly the decision to structure the sale "as a taxable transaction on day one" in contrast to "creeping vesting" or "structured vesting." J.A. 495, 500, 501. It was widely anticipated among the parties that the value of Cap Gemini stock would substantially appreciate after closing. Management explained that in order to obtain long-term capital gains treatment on future sales of Cap Gemini stock, the consulting partners must recognize the value of all the shares as taxable income in 2000, thereby setting the shares' cost basis (Internal Revenue Code ("I.R.C.") § 1012) and the required capital gains holding period (I.R.C. § 1223).[3] Ultimately, ninety-five percent of the consulting partners, including Robert Bergbauer, voted to approve the transaction.

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3. Internal Revenue Code sections directly correspond to those found in Title 26 of the United States Code.

Appendix A

After the consulting partners' vote of approval, Ernst & Young distributed the necessary contract documents to consummate the transaction. These documents included, *inter alia*, the Consulting Partner Transaction Agreement ("CPTA"), the Master Agreement, and a brokerage agreement as to the non-monetized shares (collectively "the transaction documents").

In executing the CPTA, the consulting partners warranted their receipt of Cap Gemini shares would "be a taxable transaction for U.S. federal income tax purposes," but the specific timing language about the year 2000 was not included as it was in the PID. J.A. 782. Certain provisions of the Master Agreement (1) reflected that the Cap Gemini shares "not monetized in the Initial Offering [would] be valued for tax purposes at 95% of the otherwise-applicable market price," J.A. 1047, (2) instructed the parties to treat the transaction as a sale and not to take a contrary position in any tax return without the written consent of Cap Gemini, and (3) stated that neither Cap Gemini nor its affiliates were the legal or beneficial owner of the shares received by the consulting partners.

The CPTA also contained a liquidated damages clause, which provided that consulting partners could be terminated for cause, voluntarily leaving CGE&Y, or breaching the non-compete or confidentiality provisions of their Cap Gemini employment agreements, and be required to forfeit some or all of their non-monetized shares. The percentage of Cap Gemini stock subject to

forfeiture depended upon the triggering forfeiture event.[4]

B.

Robert Bergbauer executed the required transaction documents on May 1, 2000, and received, in exchange for his CGE&Y membership interest, 10,740 shares of Cap Gemini stock subject to the limitations and restrictions noted above.[5] The Bergbauers timely filed their year 2000 federal income tax return consistent with the PID and transaction documents. On Schedule D of their 2000 return, the Bergbauers reported the value of *all* the Cap Gemini shares as taxable income. Twenty-five percent of the shares were valued at the

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4. If an event occurred triggering the forfeiture provision, partners could lose: (a) 100% of their stock before December 31, 2000; (b) 75% of their stock before the first anniversary of the closing; (c) 56.7% of their stock on or after the first anniversary of the closing and before the second anniversary of the closing; (d) 38.4% of their stock on or after the second anniversary of the closing and before the third anniversary of the closing; (e) 20% of their stock on or after the third anniversary of the closing and before the fourth anniversary of the closing; and (f) 10% on or after the fourth anniversary of the closing and prior to the end of the 4-year, 300-day restricted period. If a consulting partner was terminated for "poor performance," up to fifty percent of the prescribed percentage could be forfeited at the discretion of CGE&Y. J.A. 787.

5. Shortly after the closing, Robert Bergbauer sold twenty-five percent of his Cap Gemini stock and the proceeds were distributed to him.

full closing price of $155.30 and the remaining seventy-five percent at ninety-five percent of that value, $148.52.[6]

On each successive anniversary date of the closing, 2,013.75 shares were monetized, that is released, from the restricted brokerage account and made available to Bergbauer for sale. While the non-monetized shares were held in the restricted brokerage account, Bergbauer received the dividend income attributable to those shares.

In December 2002, CGE&Y terminated Robert Bergbauer's employment as part of a reduction in force following the "dot com bubble burst." J.A. 81. Bergbauer, however, did not forfeit any of his Cap Gemini shares and received a cash severance payment. He later found employment at KPMG where he became a full equity partner.

By 2003, in contrast to the consulting partners' expectations, the Cap Gemini share price had dropped precipitously.[7] Bergbauer and other former Ernst &

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6. The Bergbauers' 2000 return reported total capital gain income of $1,515,814, total taxable income of $2,473,832, and a federal income tax liability of $676,493.

7. The drop in share price was reflected by Bergbauer's sale of his monetized Cap Gemini shares: (1) 555 shares at $76.77 in April 2002, netting proceeds of $42,607.06; (2) 4,278 shares at $33.09 in May 2003, netting proceeds of $141,569.00; (3) 2,148 shares at $46.45 in September 2003, netting proceeds of $99,792.51; and (4) 1,074 shares at $24.68 in October 2004, netting proceeds of $26,505.67.

Young colleagues discussed the prospect of filing amended year 2000 tax returns based on "what had happened to the value of the Cap [Gemini] stock." J.A. 92.

The Bergbauers filed an amended year 2000 federal income tax return in 2003, taking the position that only the twenty-five percent of Cap Gemini shares, those which were monetized and then sold in 2000, were taxable income for that year. Citing the "lack of control over the remaining Seventy-Five (75%) of the stock in the trust," the Bergbauers contended those shares were not taxable in 2000 because Robert Bergbauer "did not receive the stock," but should have been recognized as income only in the years of monetization and valued at the much lower market rates. J.A. 914. The amended return correspondingly reduced the amount of 2000 taxable income, resulting in a claim for a refund of $253,490 plus accrued interest.

The Internal Revenue Service ("IRS") reviewed the amended return and agreed to abate the Bergbauers' year 2000 tax liability by the requested $253,490. The IRS applied $100,000 as a credit to the Bergbauers' 2001 tax liability and cut a check to them for the remainder plus accrued interest.

Upon further examination, the IRS later determined that the abatement and refund had been made in error. As a result, a civil action was brought against the Bergbauers under I.R.C. § 7405, seeking payment to the Government of the erroneous tax

refund. After the parties conducted discovery, the Government filed a motion for summary judgment contending the undisputed facts proved the value of all the Cap Gemini stock was taxable income in 2000 and the tax refund was in error. The Bergbauers responded with a cross-motion for summary judgment, arguing the abatement and refund were not erroneous because only twenty-five percent of the stock was taxable income in 2000.[8]

The district court observed that, when determining the tax treatment of a transaction, the Fourth Circuit "applies a two-pronged test which examines (1) the intent of the parties; and (2) the economic substance of the transaction," *United States v. Bergbauer*, No. 05-2132, 2008 U.S. Dist. LEXIS 66681, 2008 WL 3906784, at *8 (D. Md. Aug. 18, 2008) (citing *Gen. Ins. Agency, Inc. v. Comm'r*, 401 F.2d 324, 327 (4th Cir. 1968)), commonly termed the "economic reality" test. The court determined that the intent prong of the economic reality test showed an intent to recognize the value of all the Cap Gemini stock as taxable income in 2000. *Id.* at *10.

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8. The district court initially postponed a decision until other district courts considering the same question concerning former Ernst & Young consulting partners had an opportunity to rule. *See United States v. Bergbauer*, No. 05-2132, 2008 U.S. Dist. LEXIS 66681, 2008 WL 3906784, at *4 (D. Md. Aug. 18, 2008). To date, there are more than 200 cases pending in the lower courts or administratively with the IRS in which former Ernst & Young consulting partners have sought to defer their recognition of income from the sale of their CGE&Y interests to Cap Gemini in 2000.

The district court also concluded that the parties bargained at arms-length for, and received, real economic benefit from treating all the Cap Gemini stock as received for income tax purposes in 2000. *Id.* Accordingly, the district court awarded summary judgment to the Government and denied the Bergbauers' motion. *Id.* at *11.

The Bergbauers noted a timely appeal, and we have jurisdiction pursuant to 28 U.S.C. § 1291.

II.

We review an award of summary judgment de novo. *Desmond v. PNGI Charles Town Gaming, L.L.C.*, 564 F.3d 688, 691 (4th Cir. 2009). Summary judgment is appropriate only "if the pleadings, the discovery and disclosure materials on file, and any affidavits show that there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c)(2); *Erwin v. United States*, 591 F.3d 313, 327 (4th Cir. 2010). Because the Bergbauers' claims were rejected on summary judgment, we view the factual evidence in the light most favorable to them. *See Walker v. Prince George's County*, 575 F.3d 426, 427 (4th Cir. 2009) (citing *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 255, 106 S. Ct. 2505, 91 L. Ed. 2d 202 (1986)).

Appendix A

III.

This case presents the issue of the timing of the receipt of income: Were the Bergbauers the taxable recipients of all the Cap Gemini shares in 2000 or only the twenty-five percent monetized and available for sale? The Bergbauers do not contest the valuation of the shares, the adequacy of consideration, or challenge the validity of the transaction. They simply contend that the 8,055 non-monetized Cap Gemini shares were not "received," for income tax purposes, in 2000 and therefore should not be "recognized" as income in that year. Citing I.R.C. § 451(a), the Bergbauers argue that cash method taxpayers, like them, should report income in the tax year in which they actually or constructively receive it. *See* I.R.C. § 451(a) ("The amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer . . . .").

The Bergbauers posit that Robert was not in actual receipt of the non-monetized shares in 2000 because those shares were held in a restricted account and subject to transfer prohibitions. Citing the regulations under § 451 in 26 C.F.R. § 1.451-2(a), the Bergbauers also argue there was no "constructive receipt" of the non-monetized shares in 2000 because of both the restrictions on transfer and the risk of forfeiture.[9]

9. 26 C.F.R. § 1.451-2(a) provides in relevant part:

> Income although not actually reduced to a taxpayer's possession is constructively received by him in the

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Br. of Appellant at 20. As further support, the Bergbauers reference I.R.C. § 83(a)(2), which they claim sets the timing of recognition of income as "the first taxable year in which the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture." Br. of Appellant at 28.

Thus, if Robert Bergbauer did not "receive" the non-monetized shares in 2000, the Bergbauers argue they were not required to recognize and report the value of those shares as taxable income that year. Br. of Appellant at 23. Instead, the Bergbauers contend that the non-monetized shares were received, for income tax purposes, *seriatim* in each year after 2000 when the forfeiture restrictions lapsed and the shares were released and available for transfer. Br. of Appellant at 14–15. The Bergbauers conclude that their intention, and that of the other parties, that the "shares be deemed to have been received sooner for tax purposes could not hasten the taxability of the shares" because § 451 or § 83 foreclose that result. Br. of Appellant at 23.

The Government responds by citing the unanimous decisions from courts in other circuits addressing the

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> taxable year during which it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time, ... However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions. . . .

claims of similarly situated former Ernst & Young consulting partners, all of which have determined that the value of all the Cap Gemini shares was fully taxable in 2000. *See, e.g.*, *United States v. Fletcher*, 562 F.3d 839 (7th Cir. 2009). Recognizing that decisions from outside this Circuit use different standards in evaluating the recharacterization of a taxable transaction, the Government also argues the district court correctly applied our Court's economic reality test and that the Bergbauers' statutory argument is misplaced. Br. of Appellee at 26-27.

We note that the Bergbauers do not contend the economic reality test is invalid. Instead, the bottom line of their position is that the provisions of § 451 and § 83 supersede any application of that test and mandate their proposed tax treatment of the Cap Gemini stock. We disagree and find the district court properly applied our precedent and committed no error in awarding summary judgment to the Government.

In *Commissioner v. National Alfalfa Dehydrating and Milling Co.*, 417 U.S. 134, 94 S. Ct. 2129, 40 L. Ed. 2d 717 (1974), the Supreme Court stated:

> [W]hile a taxpayer is free to organize his affairs as he chooses, nevertheless, once having done so, he must accept the tax consequences of his choice whether contemplated or not, and may not enjoy the benefit of some other route he might have chosen to follow but did not.

417 U.S. at 149 (internal citations omitted); *Signet Banking Corp. v. Comm'r*, 118 F.3d 239, 241 (4th Cir. 1997) (same); *see also Frank Lyon Co. v. United States*, 435 U.S. 561, 583-84, 98 S. Ct. 1291, 55 L. Ed. 2d 550 (1978) (holding that "the Government should honor the allocation of rights and duties effectuated by the parties" when "there is a genuine multiple-party transaction with economic substance . . . compelled or encouraged by business or regulatory realities, . . . imbued with tax-independent considerations, and . . . not shaped solely by tax-avoidance features that have meaningless labels attached"); *id.* at 584 ("Expressed another way, . . . the form of the transaction adopted by the parties governs for tax purposes."); *accord Gray v. Powell*, 314 U.S. 402, 414, 62 S. Ct. 326, 86 L. Ed. 301 (1941) ("The choice of disregarding a deliberately chosen arrangement for conducting business affairs does not lie with the creator of the plan.").

In embracing *National Alfalfa's* principle, "courts have established very strict standards," *Furman v. United States*, 602 F. Supp. 444, 456 (D.S.C. 1984), for a taxpayer who elects "a specific course of action and then when finding himself in an adverse situation [seeks to] extricate himself by applying the age-old theory of substance over form." *Cornelius v. Comm'r*, 494 F.2d 465, 471 (5th Cir. 1974) (quotation omitted). We have recognized that "[g]enerally, taxpayers are liable for the tax consequences of the transaction they actually execute and may not reap the benefit of recasting the transaction into another one substantially different in economic effect that they might have made." *Estate of*

Leavitt v. Comm'r, 875 F.2d 420, 423 (4th Cir. 1989); *see also Signet*, 118 F.3d at 242 ("[T]he bank simply cannot structure the terms of the cardholder agreement to its advantage and then rely on an indeterminate question of Virginia law to evade the federal tax implications thereof."); *Snowa v. Comm'r*, 123 F.3d 190, 198 n.11 (4th Cir. 1997) (observing that § 1034(g) of the Internal Revenue Code "provide[d] a legislative exception to the general rule that a taxpayer cannot recharacterize a transaction to avoid the tax consequences of the form of the transaction actually chosen").

To put it plainly, we have bound taxpayers to "the 'form' of their transaction" when they attempt to recharacterize an otherwise valid agreement bargained for in good faith. *Estate of Leavitt*, 875 F.2d at 423. We have also refused to entertain arguments "that the 'substance' of their transaction triggers different tax consequences." *Id.* This precept not only maintains the vital public policy of enforcing otherwise valid contracts, but also assures the reliability of agreed tax consequences to the public fisc.

"[A]llowing the government to adopt as conclusive a result agreed to by the parties . . . provide[s] a more efficient system that . . . greatly reduce[s] the possibility of litigation . . . aimed at revising the parties' bargained agreement." *Sullivan v. United States*, 618 F.2d 1001, 1004 (3d Cir. 1980); *see also Furman*, 602 F. Supp. at 455 ("To allow a taxpayer to unilaterally reform one end of a bargain could encourage taxpayers to ignore agreements as written in the hope that the courts will

give them more advantageous tax treatment."). To do otherwise would allow situations to be created where the alteration of tax benefits, as a result of inconsistent reporting, "whip-saws" the Government and results in disastrous and unfair effects on our tax system. *Sullivan*, 618 F.2d at 1004 (recounting the previous practice of parties "advocat[ing] mutually conflicting tax characterizations of their agreement[s]," which "frequently" would compel the Commissioner "to assess inconsistent deficiencies" and to pursue litigation against both parties "in separate suit[s]," wherein the Commissioner was forced to take "divergent positions so as to avoid two adverse judgments").

There is no "disparity" in allowing "the Commissioner alone to pierce formal" agreements as "taxpayers have it within their own control to choose in the first place whatever arrangements they care to make." *Comm'r v. Danielson*, 378 F.2d 771, 775 (3d Cir. 1967) (en banc). The Government's interest lies "in having the transaction reported consistently by" the parties to the sale. *Throndson v. Comm'r*, 457 F.2d 1022, 1024 n.2 (9th Cir. 1972). In this case, the Government never challenged the Bergbauers' recognition of the value of all 10,740 Cap Gemini shares as taxable income in 2000. All the other parties to the transaction, including Cap Gemini, reported the stock transfer consistent with the Bergabuers' treatment on the 2000 return and the Commissioner has not challenged those actions.

With the foregoing in mind, our Circuit has applied a two-pronged "economic reality" test when reviewing a taxpayer's attempt to recharacterize the tax consequences of a transaction.[10] *Gen. Ins. Agency, Inc.*,

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10. Other circuits have fashioned their own standards for determining whether a taxpayer may challenge his prior treatment of the tax consequences of a transaction. As these standards do not apply in the Fourth Circuit, we mention them only for informational purposes. Two such standards are the *Danielson* rule and the "strong proof" rule. In *Commissioner v. Danielson*, 378 F.2d 771 (3d Cir. 1967) (en banc), the Third Circuit held that a taxpayer could recharacterize the terms of a transaction only if those terms were unenforceable due to "mistake, undue influence, fraud, [or] duress, etc." *Danielson*, 378 F.2d at 775; *see also Bradley v. United States*, 730 F.2d 718, 720 (11th Cir. 1984) ("A party can challenge the tax consequences of his agreement as construed by the Commissioner *only by adducing proof* which in an action between the parties would be admissible to alter that construction or to show its unenforceability because of mistake, undue influence, fraud, duress, et cetera.") (quotations omitted) (emphasis in original); *Smith v. Comm'r*, 65 F.3d 37, 40 (5th Cir. 1995) ("[A] taxpayer may argue substance over form when necessary to prevent unjust results, and when proof is offered which in an action between the parties would be admissible to alter that construction or to show its unenforceability because of mistake, undue influence, fraud, duress, etc.") (quotations and internal citation omitted).

The "strong proof" rule requires a party to adduce "strong proof" that the parties intended an allocation different than that included in the contract. *See N. Am. Rayon Corp. v. Comm'r*, 12 F.3d 583, 588 n.6 (6th Cir. 1993) ("The 'strong proof' rule requires a party seeking to disregard the express price

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401 F.2d at 329-30; *see also Volvo Cars of N. Am., LLC v. United States*, 571 F.3d 373, 379 (4th Cir. 2009) ("[W]e have long held that the parties' intent and the relevant facts are critical in construing contracts for federal tax purposes."); *Thomas v. Comm'r*, T.C. Memo 2002-108, 83 T.C.M. (CCH) 1576 (2002) (recognizing and applying the "economic reality" test). The economic reality test examines (1) the intent of the parties, and (2) the economic substance of the transaction. The determination of the parties' intent and the economic substance of the transaction are questions of fact, with the taxpayer bearing the burden of proof. *Gen. Ins. Agency, Inc.*, 401 F.2d at 329.

The district court concluded that the provisions in the transaction documents, particularly the CPTA and Master Agreement, "strongly demonstrate[d]" that it was the parties' understanding that all Cap Gemini shares would be immediately taxable at the transaction's closing. *Bergbauer*, 2008 U.S. Dist. LEXIS 66681, 2008 WL 3906784, at *5. However, the court recognized that other sections of the transaction documents, namely the forfeiture and stock transfer

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allocations in an agreement to adduce strong proof that the parties actually intended to attribute different values than those stated in the agreement."); *Rogers' Estate v. Comm'r*, 445 F.2d 1020, 1021 (2d Cir. 1971) ("In this Circuit, the rule is, that when the parties to a transaction . . . have specifically set out the covenants in the contract and have there given them an assigned value, strong proof must be adduced by them in order to overcome that declaration.") (quotation omitted).

restriction provisions, could be in conflict with immediate taxation of the non-monetized shares. *Id.* at *8-9.

Without a definitive answer from the plain language of the transaction documents, the district court turned its analysis to the extrinsic evidence, particularly the PID, and found that this evidence "shed[ ] light on the terms of the transaction documents," and demonstrated that "the parties' original intent was for the [c]onsulting [p]artners to be immediately taxed on the entirety of the shares they received at the transaction's closing on May 23, 2000." *Id.* at *10.

We conclude that the district court did not clearly err in this finding. Indeed, the Bergbauers *conceded* the intent prong of the economic reality test on appeal, *i.e.*, that the parties intended the value of all the Cap Gemini shares exchanged for the CGE&Y membership interests be fully taxed in 2000. Even without such a concession, the district court's determination of intent was strongly supported by the record evidence.

Several provisions of the PID demonstrate that the parties plainly intended for Robert Bergbauer to be immediately taxed on all 10,740 Cap Gemini shares in 2000. Not only did the PID provide that the transaction would be structured as a "taxable capital gains transaction," J.A. 285, but it also stated that "Ernst & Young, its partners, and Cap Gemini [would] treat valuation and related issues consistently." J.A. 285-86.

But, most importantly, the PID unequivocally stated that "[a]ll partners [would] vest in their shares immediately upon closing," J.A. 280, and "[t]he gain on the sale of the [CGE&Y interests] [would be] reportable on Schedule D of [their] U.S. federal income tax return for 2000." J.A. 286.

Further, Arthur Gordon, Ernst & Young's director of tax in 2000, testified that the consulting partners knew the intent of the parties was to close the transaction so they would own all the Cap Gemini shares outright that year, thus establishing a cost basis and holding period for long-term capital gain treatment of future sales of the stock. As the district court observed, "even if Robert Bergbauer did not immediately appreciate the operative tax language contained within the PID, after attending the March 7-8, 2000 meeting he was well aware that all parties to the agreement" intended for the consulting partners to be "immediately taxed" on all their Cap Gemini shares in 2000. *Bergbauer*, 2008 U.S. Dist. LEXIS 66681, 2008 WL 3906784, at *9. Finally, the Bergbauers' initial 2000 tax return, wherein they reported as income the value of all 10,740 Cap Gemini shares, demonstrates that the Bergbauers understood the intention to be taxed on the entirety of those shares in 2000.

While the parties intended immediate taxation on all the Cap Gemini shares in 2000, the "economic reality" test requires that there be economic substance to that decision. *See Halle v. Comm'r*, 83 F.3d 649, 655 (4th Cir. 1996) (explaining that "we must look beyond the parties'

terminology to the 'substance and economic realities' of the [transaction], gleaned from the totality of the circumstances surrounding the transaction"). In other words, the "economic realities surrounding the transaction in this case [must] confirm" that the parties' agreement to treat the shares as immediately taxable "accurately portrayed their intentions." *Id.*; *see also Wrangler Apparel Corp. v. United States*, 931 F. Supp. 420, 426 (M.D.N.C. 1996) ("The second prong of the *General Insurance* test requires that the covenant bargained for have some independent value grounded in economic reality.").

All parties to the transaction, bargaining at arms-length, had economic reasons to subject the entirety of the consulting partners' Cap Gemini stock to full and immediate taxation in 2000. For consulting partners, like Robert Bergbauer, immediate taxation in 2000 was the means to both start the holding period for capital gains treatment under I.R.C. § 1223, and at the same time establish a high cost basis under I.R.C. § 1012. Both elements were key for Bergbauer and his colleagues to achieve their goal of minimizing tax when they later disposed of the Cap Gemini stock after its anticipated high rise in value.

Cap Gemini, on the other hand, sought to fix its cost basis for the acquired assets in CGE&Y, and, in turn, its amortization deductions under I.R.C. § 197. This course of action also enabled all of the parties to avoid future litigation over conflicting opinions of value if anything other than the agreed value of the Cap Gemini stock was used for tax reporting purposes.

Appendix A

While the stock transfer restrictions and forfeiture provisions presented a potential risk to the consulting partners during the non-monetization period, these provisions were mutually beneficial, in part, to all parties' economic interests. The forfeiture provision clearly benefitted Cap Gemini as a retention mechanism to preserve the consulting partners' client relationships, goodwill, and expertise. But other economic benefits accrued to Cap Gemini and the consulting partners as well. As Arthur Gordon testified:

> The purpose of the restricted account was to protect the value of the stock. In one moment of time we doubled the number of issued and outstanding shares of Capgemini, the public company. The feeling was if everybody was allowed to go to the market at once, the stock would plummet because you had too many shares without enough buyers. So in order to protect everybody's value, the partners agreed that they would voluntarily restrict their shares with the consideration being that everybody else will restrict their shares. . . .
>
> . . . And it was an agreement that we would all lose certain rights for the benefit of the whole and for us individually.

J.A. 431-32. Thus, it was in each consulting partner's economic interest to agree to restrict every other consulting partner's transfer and sale of shares.

Flooding the market with Cap Gemini shares would only depress the price of the stock, thereby damaging every party's economic interest in the transaction.

We therefore conclude that the district court did not err in its conclusion that the terms of the transaction contained "some economic substance beyond the parties' subjective intent." *Bergbauer*, 2008 U.S. Dist. LEXIS 66681, 2008 WL 3906784, at *10. The district court properly determined that the second prong of the economic reality test was met because the terms of the transaction were grounded in "business reality such that reasonable men, genuinely concerned with their economic future, might bargain for such an agreement." *Gen. Ins. Agency, Inc.*, 401 F.2d at 330.

Thus, the value of all the Cap Gemini shares should have been recognized as taxable income in 2000, as agreed to and reported by all parties, unless the Bergbauers' statutory arguments mandate a different result. We conclude those arguments are without merit.

The Bergbauers' argument as to § 83 is readily rejected. The restrictions under that statute on the recognition of income for property not "transferable" or "subject to a substantial risk of forfeiture" applies only if the property is transferred "in connection with the performance of services." I.R.C. § 83(a). The CGE&Y for Cap Gemini equity interest exchange was clearly not related to the performance of services and the Bergbauers do not contend to the contrary. Thus, the plain terms of § 83 verify that statute has no application to this case.

Appendix A

The argument as to I.R.C. § 451 is similarly unavailing. If Robert Bergbauer had received the Cap Gemini stock in the absence of an agreement, but subject to the forfeiture and restricted transfer provisions, his timing argument for the year of income recognition might have more credence. Of course, he did not receive the Cap Gemini stock in the abstract or in a vacuum. Neither are the tax consequences to be adjudicated in that context, but upon the totality of the circumstances. As the legion of caselaw set forth above clearly illustrates, a taxpayer's choice of tax treatment under a binding contract is not an optional commitment. "[T]axpayers are liable for the tax consequences of the transaction they actually execute and may not reap the benefit of recasting the transaction into another one substantially different in economic effect that they might have made." *Estate of Leavitt*, 875 F.2d at 423.

In this case, the parties bargained for mutually beneficial tax consequences with the consulting partners receiving a high basis for future capital gains treatment in exchange for immediate taxation in 2000. At the same time, Cap Gemini received a set amortization basis in exchange for foregoing the opportunity (or risk) of a different basis if a structured stock-distribution schedule were used. This allocation fixed the tax consequences for both parties and enabled the Government to receive the benefit of higher taxable income from the consulting partners in 2000, offset over time by Cap Gemini's higher-based amortization deductions in later years, as well as the potential reduced tax when the consulting partners sold Cap Gemini stock at long-term capital gains rates.

The Bergbauers point to no statute or caselaw which would permit them to unilaterally change the agreed upon tax treatment of the transaction, years after the fact, because their prior choices no longer serve their economic interests. Nothing in § 451 or any other provision of the Internal Revenue Code permits a taxpayer to whipsaw the Government and the other parties to the transaction by unilaterally altering the agreed tax treatment, which has economic substance and reflects his intent, after the fact when the winds of change foment delayed seller's remorse. The principle established in *National Alfalfa* is as valid now as when pronounced nearly four decades ago and settles the issue raised by the Bergbauers:

> [W]hile a taxpayer is free to organize his affairs as he chooses, nevertheless, once having done so, he must accept the tax consequences of his choice, whether contemplated or not, and may not enjoy the benefit of some other route he might have chosen to follow but did not.

417 U.S. at 149 (internal citations omitted); *Signet Banking Corp.*, 118 F3d at 241 (same).

We therefore reject the Bergbauers' contention that § 451 grants them the authority to rewrite the tax treatment of the Cap Gemini stock which they agreed upon, and did, treat as fully taxable income in 2000 and for which there were reasons of bona fide economic substance.

Appendix A

IV.

As the record reflects, both prongs of the "economic reality" test have been satisfied and the district court did not err in so finding. Accordingly, we affirm the district court's grant of summary judgment to the Government and the court's denial of summary judgment to the Bergbauers.

AFFIRMED

APPENDIX B — MEMORANDUM OPINION OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MARYLAND DATED AUGUST 18, 2008 AND FILED AUGUST 19, 2008

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MARYLAND

Civil Action No. RDB-05-2132

UNITED STATES OF AMERICA

Plaintiff

v.

ROBERT L. BERGBAUER et ux.

Defendants

MEMORANDUM OPINION

Pursuant to 26 U.S.C. §7405, the Government has brought this suit against Robert and Marie Bergbauer to reclaim an erroneous tax refund of $276,510, plus statutory interest on that amount, accruing from August 4, 2003. The parties have filed cross motions for summary judgment under Rule 56 of the Federal Rule of Civil Procedure. At a motions hearing held on July 16, 2008, the parties presented legal arguments in support of the pending motions and agreed that no material facts remain in dispute. Under the two-prong, "economic reality" test of the United States Court of

Appendix B

Appeals for the Fourth Circuit, this Court finds that the parties intended to treat the underlying transaction as a fully and immediately taxable event. Accordingly, for the reasons set forth below, the Defendants' Cross-Motion for Summary Judgment (Paper No. 33) is DENIED and the Government's Motion for Summary Judgment (Paper No. 28) is GRANTED.

BACKGROUND

The material facts governing this case are not in dispute. In autumn 1999, Ernst & Young LLP ("Ernst & Young ") and Cap Gemini, S.A. ("Cap Gemini ") began discussing the sale of Ernst & Young's consulting business. These discussions materialized when Cap Gemini acquired Ernst & Young's consulting business on May 23, 2000 ("the transaction"). Under the terms of the transaction, Cap Gemini purchased Ernst & Young's consulting business by issuing shares of its stock, subject to certain restrictions, to Ernst & Young's accredited consulting partners ("Consulting Partners"). There is no dispute that Robert Bergbauer was a Consulting Partner. When the transaction closed, Robert Bergbauer left Ernst & Young and joined the newly-formed Cap Gemini Ernst & Young ("CGE&Y"), the Cap Gemini affiliate established to take over Ernst & Young's consulting division. (Gov't's Mem. Supp. Summ. J. Ex. 1 at 8:19-9:12.)

Appendix B

I. The Cap Gemini - Ernst & Young Transaction

On March 2, 2000, pursuant to their ongoing negotiations with Cap Gemini, but before the transaction's consummation, Ernst & Young distributed to its Consulting Partners a Partner Information Document and related appendices (collectively, the "PID"), dated March 1, 2000. (*Id.* Exs. 2 and 7.) In pertinent part, the PID indicated that the agreed purchase price for Ernst & Young's consulting business was structured as a fully taxable asset sale (approximately $6.71 billion), allocated as follows:

Ernst & Young LLP	$2.145 billion, consisting of • 375 million cash and remainder in Cap Gemini stock
Ernst & Young consulting partners	$2,191 billion of Cap Gemini stock
Ernst & Young non-consulting (audit and tax) partners	$2,374 billion of Cap Gemini stock

(*Id.* Ex. 2, at CG000026.) The PID also indicated that the Consulting Partners would receive Cap Gemini stock, recognize gain, and incur federal and state income tax at the 25 percent capital gains rate. Under the PID, the Consulting Partners' would be permitted to immediately sell 25 percent of Cap Gemini shares

received to meet their year 2000 tax burden, but the remainder would be "monetized" for installment sales over the next four years and 300 days. (*Id.* Ex. 2, at CG000034.) The PID stated that the Consulting Partners would vest in their Cap Gemini shares immediately upon the closing of the transaction. It also stated that the shares would "be held in an individual account in an institution such as Merrill Lynch or Citigroup and [would] be subject to resale restrictions imposed by Cap Gemini . . . and under the U.S. securities laws." The PID disclaimed that its contents were "not to be construed as business, legal, or tax advice" and that each Consulting Partner "must rely . . . on the terms of the transaction." (*Id.* at CG000055.)

The PID explained that consent to the transaction was required by a 75 percent super-majority of Consulting Partners. (*Id.* at CG000058.) At a March 7-8, 2000 meeting, the Consulting Partners (including Bergbauer) voted overwhelmingly (approximately 95 percent) to move forward with the transaction. (*Id.* Ex. 6, Arthur Gordon Dep., at 53:19-54:20.) Prior to the meeting, Bergbauer had the opportunity to review the PID, including the portion entitled "Tax Implications." At the meeting, Ernst & Young's management made a presentation to the Consulting Partners, including Bergbauer, and answered questions regarding the proposed transaction and its tax implications. (*Id.* at 26:1-26:19; 46:10-48:11; 49:7-49:16; 144:10-147:22.) One presenter, a former Ernst & Young partner, later offered testimony explaining that he explicitly fielded questions

regarding the immediate taxability of the shares. He reported that a vesting schedule was disfavored because the parties viewed the transaction as a sale of assets and not an installment sale. Furthermore, he explained that the transaction was structured for immediate taxation on shares received by the Consulting Partners to both avoid compensation issues for the newly formed CGE&Y and to ensure favorable tax treatment for the Consulting Partners' future sale of their Cap Gemini shares. (*Id.* at 149:2-151:17.)

Subsequently, on April 7, 2000, the Consulting Partners received a "Partner Transaction Agreement Kit" with copies of legal documents that the Consulting Partners were required to execute pursuant to the transaction. (*Id.* Ex. 1, at 52:20-22.) Upon signing the Consulting Partner Transaction Agreement ("CPTA") on May 1, 2000, Bergbauer became a party to the Master Agreement and all tax related provisions within both the Master Agreement and the CPTA. (*Id.* Ex. 10, at CG4069-4070, 4011, 4068.) Together, the Master Agreement and the CPTA constitute the operative transaction documents to the sale. (*Id.* Ex. 2, at CG000032.)

With respect to the Master Agreement, the relevant tax provisions in this case are sections 7.7(f) and 7.7(h). Section 7.7(f)(i) of the Master Agreement provided that Bergbauer "agreed to determine the value of and allocate" the Cap Gemini stock as consideration for its purchase of Ernst & Young's consulting business. Further, it stated that "the determination and allocation

derived . . . shall be binding upon [Ernst & Young, the Consulting Partners and Cap Gemini] for all U.S. federal, state and local Tax reporting purposes." (*Id.* Ex. 3, at CG000541.) Section 7.7(f) also stated that shares "that are not monetized in the Initial Offering will be valued for tax purposes at 95 [percent] of the otherwise-applicable market price." (Defs.' Mem. Supp. Cross Mot. Summ. J. Ex. A.) To supplement section 7.7(f), section 7.7(h) addressed the manner in which the Consulting Partners would report the sale of Ernst & Young's consulting business to Cap Gemini for tax purposes and required that "each Accredited Partner agree not to take any position in any tax return contrary to the foregoing without the written consent of [Cap Gemini]." (Gov't's Mem. Supp. Summ. J. Ex. 3, at CG000543-CG000544.)

Section 5(b)(xii) of the CPTA provided:

> ***Taxable Transaction; Tax Reporting.*** You understand that your receipt to Cap Gemini shares in the Transaction will be a taxable transaction for U.S. federal income tax purposes . . . . You acknowledge your obligation to treat and report the Transactions for all relevant tax purposes in the manner provided in Sections 7.7(f) and (h) of the Master agreement (as agreed to by Cap Gemini, (Ernst & Young], you and the other Accredited Partners).

(*Id.* Ex. 9, at CG4023.) Under section 5(b)(x), Bergbauer warranted that he had read the PID and transaction

agreements, was not relying on any information other than the PID agreements, and was given an opportunity to ask questions about the terms and conditions of the transaction. (*Id.* Ex. 9, at CG4023; Ex. 6, at CG66:8-68:13.) Effectively, Bergbauer's signature bound him to the tax provisions in sections 7.7(f) and 7.7(h) of the Master Agreement.

Section 8 of the CPTA prohibited a Consulting Partner from selling Cap Gemini stock for a period of four years and 300 days from the date of the transaction except in public offerings and certain other "permitted Divestitures." (*Id.* Ex. 9, at CG4026-CG4027, CG4046-CG4050.) Additionally, it provided that all Cap Gemini shares held in the Merrill Lynch Restricted Account were to be voted by Merrill Lynch's French affiliate as instructed by the Consulting Partner. (*Id.* at CG4027, § 8(d).) Finally, under section 8, the Consulting Partners were allowed to accumulate dividend income in their Restricted Accounts.[1]

The "liquidated damages" clause, section 9 of the CPTA, provided that Bergbauer was required to forfeit some or all of his Cap Gemini shares if he was terminated

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1. Accordingly, dividends were deposited into Bergbauer's Restricted Account and he reported dividend income in the amounts of $ 8,474 in 2001, $ 5,740 in 2002, and $ 762 in 2003. (Gov't's Mem. Supp. Summ. J. Ex. 16 at Interrogs. 18, 19, and 20.) Later, after the requisite tax was paid on each dividend disbursement, the net dividend was moved from the Restricted Account to an accessible, unrestricted account. (See *Id.* Exs. 35, 36, 37, 45, 46, 48.)

for cause, voluntarily left CGE&Y, or breached the non-competition or confidentiality provisions of his Cap Gemini employment agreement. Specifically, section 9 provided as follows:

Timing of Event	% of Cap Gemini Stock Forfeited
Prior to 12/31/2000	100%
Prior to first anniversary of Closing	75.0%
After first anniversary and prior to second anniversary of Closing	56.7%
After second anniversary and prior to third anniversary of Closing	38.4%
After third anniversary and prior to fourth anniversary of Closing	20.0%
After fourth anniversary and prior to four years and 300 days after Closing	10.0%

(*Id.* at CG4027-CG4028, § 9(a); see also Ex. 2 at CG 000036-CG000040.) Additionally, if Bergbauer was terminated for "poor performance," up to 50 percent of these percentages would also be forfeitable at the discretion of CGE&Y officials. (*Id.* at CG4028, § 9(b).)

Finally, under section 10 of the CPTA, Consulting Partners granted power of attorney to the CEO of Cap

Gemini or his designee. The power of attorney permitted the CEO to execute transaction documents in connection with the transaction on behalf of Bergbauer, enforce restrictions on transfer and liquidated damages provisions, and implement the resale of Cap Gemini shares. (*Id.* at CG4029-CG4030, § 10 (power of attorney).) Pursuant to section 10, Bergbauer executed a Special Account Instruction with Merrill Lynch agreeing that an Authorized Signatory would instruct Merrill Lynch as to (1) voting and transfers of Bergbauer's Cap Gemini stock pursuant to section 8 of the CPTA, (2) holding Cap Gemini stock and other assets in Bergbauer's Restricted Account until the restrictions and liquidated damages provisions ended, and (3) transferring Cap Gemini stock and other assets from Bergbauer's Restricted Account to another account when the limitations expired. (*Id.* Ex. 11, Special Account Instruction Agreement; Ex. 9, at CG4026-CG4029.)

II. The Transaction's Applicability to Bergbauer

As part of the transaction, Ernst & Young paid Bergbauer the value of his partnership interest. In return, Bergbauer transferred his interest to CGE&Y for 10,740 shares of Cap Gemini stock subject to the restrictions imposed by the transaction. (*Id.* Ex. 1, at 70:6-19.) Around May or June 2000, Bergbauer sold 2,685 shares (25 percent) to pay his year 2000 income taxes. (*Id.* Ex. 15, at Resp. To Interrog. 6.) As of December 31, 2000, 8,055 shares (the remaining 75 percent of the 10,740) resided in Bergbauer's Merrill Lynch Restricted Account and were subject to all restrictions and

liquidated damages as per the transaction. (*Id.* Ex. 9, at CG4026-CG4027, § 8.) The shares were valued for tax purposes at 95 percent of their market value. (The market value at the time was $155.30 per share, 95 percent of which was $148,527 per share.)

III. The Bergbauers' Original and Amended Year 2000 Tax Returns

The Bergbauers filed a joint return on or about July 13, 2001, consistent with the transaction being a fully taxable event to the Consulting Partners. The initial tax return was prepared by Ernst & Young. This return reported $1,613,379 gross sale proceeds from the transaction in accordance with the Form 1099-B issued to Bergbauer by Cap Gemini, leading to a total federal tax liability of $676,493. (*Id.* Ex. 13.) Two years later, after Cap Gemini's share value had precipitously dropped to approximately $16 per share, the Bergbauers sought alternative means to profit on the transaction. (*See* Ex. 47.) Heeding the advice that similarly situated Consulting Partners received,[2] the

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2. As will be discussed infra, Bergbauer was not the only former Consulting Partner that filed an amended return. In *United States v. Culp*, No. 05-0522, 2006 U.S. Dist. LEXIS 95030 (M.D. Tenn., December 29, 2006), the first federal case addressing this issue, the court stated as follows:

> This case is the first of twelve cases involving the Cap Gemini issue that the IRS, to date, has referred to the Tax Division. Presently, there are in excess of two hundred (200) actions related to this action

(Cont'd)

Bergbauers filed an amended federal income tax return for the year 2000 on or about June 3, 2003. (*Id.*, Ex. 14.) The Bergbauers' amended return relied on the proposition that the transaction was not a fully taxable event to the sellers. (*Id.* Ex. 1 at 31:4-17.) Based on this assumption, the Bergbauers reduced the amount of reported taxable income by $1,232,277 (alleging that the 75 percent of Cap Gemini shares, valued at 95 percent, had not yet been taken into income) and claimed a total tax reduction of $253,490. (*Id.* Ex. 14.) Of this, $153,490 was to be refunded and $100,000 was to be applied to their 2001 estimated tax. (*Id.*)

On or about August 4, 2003, the Internal Revenue Service ("IRS") abated $253,490 of tax for 2000, applied a $100,000 credit to the Bergbauers estimated 2001 tax, and cut a refund check payable to Robert and Marie Bergbauer in the amount of $176,510, consisting of the $153,490 refund and $23,020 of interest. (Compl. PP 14, 15, 16.) Later, the IRS alleged error and the Government brought the instant suit against the Bergbauers to recover the refund pursuant to 26 U.S.C. §7405.

(Cont'd)

> pending in different forums across the country. The different forums involved include the IRS Appeals Office, the United States Tax Court, the United States Court of Federal Claims, and other United States District Courts. These actions are based on virtually the identical substantive tax issue involved with this litigation, the Cap Gemini Issue.

2006 U.S. Dist. LEXIS 95030 at *2 -*3; *see also United States v. Fletcher*, No. 06-6056, 2008 U.S. Dist. LEXIS 3555 (N.D. Ill., January 15, 2008).)

Appendix B

The Government filed the initial Complaint on August 4, 2005. Robert Bergbauer is one of over 200 similarly situated individuals throughout the country seeking to resolve the tax implications of the Cap Gemini -- Ernst & Young transaction. As such, this Court granted a Motion to Stay on May 29, 2007, lasting approximately 15 months, while other district courts addressed the issue. After the stay was lifted, both the Government and the Bergbauers moved for judgment as a matter of law under Rule 56 of the Federal Rule of Civil Procedure.

STANDARD OF REVIEW

Rule 56 of the Federal Rules of Civil Procedure provides that summary judgment "shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no *genuine* issue as to any *material* fact and that the moving party is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c) (emphasis added). In *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 106 S. Ct. 2505, 91 L. Ed. 2d 202 (1986), the Supreme Court of the United States explained that only "facts that might affect the outcome of the suit under the governing law" are material. *Id.* at 248. Moreover, a dispute over a material fact is genuine "if the evidence is such that a reasonable jury could return a verdict for the nonmoving party." *Id.*

The Supreme Court further explained that, in considering a motion for summary judgment, a judge's

function is limited to determining whether sufficient evidence supporting a claimed factual dispute exists to warrant submission of the matter to a jury for resolution at trial. *Id.* at 249. In that context, a court is obligated to consider the facts and all reasonable inferences in the light most favorable to the nonmoving party. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587, 106 S. Ct. 1348, 89 L. Ed. 2d 538 (1986); *see also E.E.O.C. v. Navy Federal Credit Union*, 424 F.3d 397, 405 (4th Cir. 2005). Rule 56 mandates summary judgment against a party "who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial." *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986).

When both parties file motions for summary judgment, as here, the court applies the same standards of review. *Taft Broad. Co. v. United States*, 929 F.2d 240, 248 (6th Cir. 1991); *ITCO Corp. v. Michelin Tire Corp.*, 722 F.2d 42, 45 n.3 (4th Cir. 1983) ("The court is not permitted to resolve genuine issues of material fact on a motion for summary judgment — even where . . . both parties have filed cross motions for summary judgment.") (emphasis omitted), cert. denied, 469 U.S. 1215, 105 S. Ct. 1191, 84 L. Ed. 2d 337 (1985). The role of the court is to "rule on each party's motion on an individual and separate basis, determining, in each case, whether a judgment may be entered in accordance with the Rule 56 standard." *Towne Mgmt. Corp. v. Hartford Acci. & Indem. Co.*, 627 F. Supp. 170, 172 (D. Md. 1985). When cross-motions for summary judgment

demonstrate a basic agreement concerning what legal theories and material facts are dispositive, they "may be probative of the non existence of a factual dispute." *Shook v. United States*, 713 F.2d 662, 665 (11th Cir. 1983) (citation omitted).

DISCUSSION

At the motions hearing conducted on July 16, 2008, the parties agreed that the dispute between them hinges on conflicting interpretations of law, thus making the pending cross motions ripe for disposition at the summary judgment stage. The disagreement between the parties, in substance, can be summarized as follows. The Government contends that Robert Bergbauer is an asset seller and that the 10,740 shares of Cap Gemini stock were fully taxable on the closing date under 26 U.S.C. § 1001 and in accordance with the contract terms agreed by Ernst & Young and Cap Gemini and to which Bergbauer assented in writing. The Bergbauers contend, however, that Robert Bergbauer received only 2,685 shares of Cap Gemini stock when the transaction closed on May 23, 2000, and that the remaining 8,055 shares were not taxable until the transferability restrictions and liquidated damages provisions of the CPTA lapsed.

The Cap Gemini — Ernst & Young transaction involved a great many Consulting Partners, and Bergbauer is far from the only Consulting Partner seeking to retain a tax refund after filing an amended return with the IRS. Indeed, counsel for the

Government indicated at the hearing that, upon resolution of this case, six cases remain pending in federal district courts on the same legal issue, although this estimate has not been confirmed. Additionally, a presently unknown number of cases also remain pending in various other forums across the country, including the IRS Appeals Office, the United States Tax Court, and the United States Court of Federal Claims.

Two cases, *United States v. Culp*, No. 05-0522, 2006 U.S. Dist. LEXIS 95030 (M.D. Tenn., December 29, 2006) and *United States v. Fletcher*, No. 06-6056, 2008 U.S. Dist. LEXIS 3555 (N.D. Ill., January 15, 2008), have already been decided in other federal district courts. In both cases, the court granted summary judgment to the Government, finding that the entire transaction was taxable in 2000.

In *Culp*, the first case involving the Cap Gemini — Ernst &Young transaction, the United States District Court for the Middle District of Tennessee applied traditional contract principles and discussed whether the restrictions contained in the transaction documents were conditions subsequent or conditions precedent. Focusing on the contract language used in the transaction documents, the court found that the restrictions were conditions subsequent to receiving the shares. Therefore, under *Commissioner v. Danielson*, 378 F.2d 771 (3d. Cir. 1967), the defendant could "recharacterize" the terms of the deal only if they were unenforceable due to "mistake, undue influence, fraud or duress." *Id.* at 775. The court concluded that the

Danielson rule did not apply and granted summary judgment for the Government.

In *Fletcher*, the United States District Court for the Northern District of Illinois found that the transaction documents were ambiguous and susceptible to more than one reasonable interpretation. The court concluded that the PID, viewed as extrinsic evidence, demonstrated the parties' intention to treat the sale as a fully and immediately taxable event. Addressing the defendant's argument that immediate taxation was in contravention of 26 U.S.C. § 451, the court balanced the intention of the parties, on the one hand, with the public policy embodied in the Internal Revenue Code ("the Tax Code"), on the other. The court concluded that under either the Danielson rule or the "strong proof rule, *see Leslie S. Ray Ins. Agency, Inc. v. United States*, 463 F.2d 210, (1st Cir. 1972) (requiring "strong proof that the parties intended an allocation different than that included in the contract), the result was the same: the sale was an immediately and fully taxable event and the Government was entitled to summary judgment.

The United States Court of Appeals for the Fourth Circuit, however, has neither adopted the *Danielson* rule nor the "strong proof" rule. Instead, the Fourth Circuit, when faced with a tax recharacterization case, applies a two-pronged test that examines the tax consequences contemplated by the parties and the economic substance of the agreement. *Wrangler Apparel Corp. v. United States*, 931 F. Supp. 420, 424 (M.D.N.C. 1996) (citing *General Ins. Agency Inc. v.*

Comm'r, 401 F.2d 324 (4th Cir. 1968).) In short, as outlined by the operative transaction documents and further clarified by the PID, Cap Gemini, Ernst & Young, and Robert Bergbauer all sought immediate taxation on the entire 10,740 shares at the close of the transaction. Furthermore, both sides received bargained-for consideration, thereby supporting the requisite economic substance of the transaction.

I. The Government Has the Statutory Authority to Seek Refund

As an initial matter, Defendants argue that the Government's case is not over a refund, but instead involves a mere deficiency in amounts owed. *See* 26 U.S.C. § 6211(a). As such, the appropriate vehicle for recovery under the Tax Code is an assessment and, if necessary, actions to foreclose liens or reduce assessments to judgment. *See* 26 U.S.C. §§ 6321-6326, 7403. Alternatively, Defendants argue that erroneous refund suits are limited to situations in which the IRS makes an erroneous, bona fide error in computation, such as a "clerical misunderstanding, . . . controlling decisions overruled or undermined, . . . [or] a simple change of mind by the [IRS] on the substantive law." *United States v. Russell Mfg. Co.*, 349 F.2d 13, 17 (2d Cir. 1965).

The Tax Code permits the Government to recover an erroneous refund by filing suit under 26 U.S.C. § 7405. Section 7405(b) provides that "[a]ny portion of a tax imposed by this title which has been erroneously

refunded (if such refund would not be considered as erroneous under section 6514) may be recovered by civil action brought in the name of the United States." 26 U.S.C. § 7405(b). As the Government notes, there are two categories of erroneous refunds: rebate and non-rebate. *See O'Bryant v. United States*, 49 F.3d 340, 342 (7th Cir. 1995). A rebate refund is issued on the basis of a substantive recalculation of the tax owed, while a non-rebate refund arises out of clerical or computer errors by the IRS. In the instant case, Defendants undisputedly received a rebate refund because the IRS abated $276,510 worth of tax on the basis of a substantive recalculation pursuant to Defendants' 2003 amended return. Therefore, the Government appropriately filed the instant suit, and this Court has jurisdiction over the matter.

II. Application Of The Fourth Circuit's Two-Pronged Approach Does Not Alter the Outcome Reached in *Culp* and *Fletcher*

In *Commissioner v. National Alfalfa Dehydrating and Milling Co.*, 417 U.S. 134, 94 S. Ct. 2129, 40 L. Ed. 2d 717 (1974), the Supreme Court stated as follows:

> while a taxpayer is free to organize his affairs as he chooses, nevertheless, once having done so, he must accept the tax consequences of his choice whether contemplated or not [citations omitted], and may not enjoy the benefit of some other route he might have chosen to follow but did not.

Id. at 149; *see also Signet Banking Corp. v. Comm'r*, 118 F.3d 239, 241 (4th Cir. 1997). Although the Fourth Circuit has not adopted either the Danielson rule (relied upon in Culp and Fletcher) or the "strong proof" test (cited and discussed in Fletcher), the "economic reality" approach used to determine tax consequences in this circuit embraces the principles set forth in National Alfalfa. In *Furman v. United States*, 602 F. Supp. 444 (D.S.C. 1984), the court wrote as follows:

> To allow a taxpayer to unilaterally reform one end of a bargain could encourage taxpayers to ignore agreements as written in the hope that the courts will give them more advantageous tax treatment. Both parties to a transaction could enjoy tax benefits due to inconsistent reporting of the same transaction. To allow taxpayers to so "whipsaw" the Commissioner would have disastrous effects on our tax system.

Id. at 455; *see also Pantry Pride v. Stop & Shop Cos., Inc.*, 630 F. Supp. 637, 640 (E.D. Va. 1986) (holding that allowing a taxpayer to escape an unfavorable outcome would jeopardize the entire transaction--"Here Pantry Pride and Richmond freely agreed to the allocation now complained of. Having made its own bed, Pantry Pride will have to lie in it.").

"[W]hen addressing the tax consequences of a transaction the [Fourth Circuit] applies a two-prong test which examines (1) the intent of the parties; and (2) the

economic substance of the transaction." *Wrangler Apparel Corp.*, 931 F. Supp. at 424 (citing *General Ins.*, 401 F.2d at 327). Applying this standard with the principles of National Alfalfa in mind, the Government is entitled to judgment as a matter of law.

A. Intent of the Parties

This Court looks first within the four corners of the operative transaction documents (namely, the Master Agreement and the CPTA) for the parties' expressed intent regarding the tax implications at the transaction's closing. As in *Fletcher*, this Court finds that the terms within the Master Agreement and the CPTA may be interpreted two different ways.

Both documents contained provisions that strongly demonstrate that Bergbauer's shares were immediately and fully taxable at the transaction's closing. For example, the CPTA provided that the Consulting Partners would receive their shares "[a]t the Closing," and that these shares would "be a taxable transaction for U.S. federal income tax purposes." (Gov't's Mem. Supp. Summ. J. Ex. 9, at 000620-26.) Furthermore, the Master Agreement stated that: (1) Cap Gemini would deliver the shares allotted to each Consulting Partner to the restricted account on his or her behalf and "provide . . . to . . . each [Consulting Partner] a Form 1099-B" with respect to the transaction; (2) the Consulting Partners would file their tax returns "for the year in which the Closing occurs;" (3) for federal tax purposes, "the transactions undertaken pursuant to

[the agreement] will be treated and reported by [all parties] as . . . a sale of the [Consulting Partner's] interests in CGE&Y to Cap Gemini;" and (4) Cap Gemini did not legally own the transferred shares, even if the shares were "held in custodial accounts and/or Trusts" for the Consulting Partners. (*Id.* Ex. 3, at 000046-47, 000121-24, 000143.) The Master Agreement explained further that "neither [Cap Gemini] nor any of its Affiliates will be a legal or beneficial owner of Transaction Shares" in the custodial accounts established for the Consulting Partners. (*Id.* Ex. 3A, at 000560.)

On the other hand, the CPTA also contained provisions that placed limitations and/or restrictions on the Defendant's use of 8,055 shares. Consequently, Defendant argues that, as a matter of law, Bergbauer did not receive the shares subject to the limitations and restrictions, and therefore could not be taxed on them under 26 U.S.C. § 451.[3] Specifically, under the CPTA,

3. The Tax Code requires cash method taxpayers, like Defendants here, to report income in the tax year in which they actually or constructively receive it. See 26 U.S.C. § 451(a) ("The amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer."); 26 C.F.R. § 1.451-1(a) ("Gains, profits, and income are to be included in gross income for the taxable year in which they are actually or constructively received by the taxpayer."). Under the regulations interpreting section 451, a taxpayer has constructively received income when "it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time." 26 C.F.R. § 1.451-2(a). If the taxpayer's ability to control the account "is subject to substantial limitations or restrictions," then the income is not deemed to have been constructively received. *Id.*

Bergbauer could not "directly or indirectly, sell, assign, transfer, pledge, grant any option with respect to or otherwise dispose of any interest in" Cap Gemini Shares, except in periodic offerings organized by Cap Gemini, for a period of four years and 300 days after the closing. (*Id.* Ex. 9, at 000597-98.) Second, Bergbauer granted Cap Gemini exclusive authority to invest, transfer and release the shares in his Merrill Lynch Restricted Account during that time period. (*Id.* at 000627-31.) Third, under the liquidated damages clause of the CPTA, Bergbauer agreed that he would forfeit some or all of the Cap Gemini shares if he breached provisions of the employment agreement with CGE&Y, voluntarily ended his employment, or was terminated "for cause" or "poor performance."[4] (*Id.* at 000641.)

Because of the conflicting provisions of the transaction documents, this Court is unable to determine with any certainty the parties' intent at the time the transaction closed. Therefore, this Court will look to extrinsic evidence (namely, the PID, testimony of a former Ernst & Young partner, and parties' actions after closing) to examine the parties' intent with respect to taxation.

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4. Both "cause" and "poor performance" were left undefined by the transaction documents.

Appendix B

1. The PID Explicitly Provided For Immediate Taxation on The Shares in Their Entirety

As demonstrated by the PID's provisions, the parties plainly intended for Bergbauer to immediately receive and be taxed on all 10,740 Cap Gemini shares. The PID expressly stated that "[e]ven though both [Cap Gemini] and the [Consulting] partners are sellers in this transaction, the [Consulting] partners are treated as though they receive[d] all of the gain and are taxed on it." (*Id.* Ex. 2 at 000726-27.) Moreover, the PID further explained that "[t]he fair market value of the stock received that cannot be sold immediately will be calculated at 95 [percent] of the closing price of Cap Gemini stock *on the day of the exchange* for [CGE&Y] shares." (*Id.* at 000041 (emphasis added).) The PID also stated that "[t]he gain on the sale of the distributed [CGE&Y] shares is reportable on Schedule D of your U.S. federal income tax return for 2000." (*Id.* at CG000042.) Lastly, it emphasizes the parties' desire to report the transaction consistently, saying that "[i]t also has been agreed that Ernst & Young, its partners, and Cap Gemini will treat valuation and related issues consistently for US federal income tax purposes."[5] (*Id.* at CG000041-42.)

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5. The PID has evidentiary value despite the fact that it was prepared prior to the transaction's closing. The fact that the parties all had the same understanding of the transaction documents before signing is persuasive. Moreover, the PID remains persuasive to this Court even though it disclaims that its "contents . . . are not to be construed as legal, business, or tax advice . . . . [Y]ou must rely on your own examination of Cap

(Cont'd)

Appendix B

2. A Former Ernst & Young Partner Explained The Immediate Taxability to The Consulting Partners

Supplementing the language contained within the PID, a former Ernst & Young partner's testimony regarding his presentation on the transaction's tax consequences at the March 7-8, 2000 meeting affords additional weight to the Government's contention that the parties desired immediate taxation on the received Cap Gemini shares. In pertinent part, the Ernst & Young partner testified that there was a discussion at the meeting concerning immediate vesting upon the transaction's closing and that "people were extraordinarily optimistic that the stock was going to rise at some exponential rate." (*Id.* Ex. 6, at 144:10-145:7.) Moreover, he testified that "we all wanted to own the shares outright and all wanted to get the capital

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(Cont'd)

Gemini and the terms of the transaction." (Gov't's Mem. Supp. Summ. J. Ex. 2 at CG000055. (emphasis supplied).)

Defendants also argue that the PID contains "oblique" language, citing the subsection titled "Subsequent Stock Sales." This subsection was part of a larger, four-page section which addressed the "Tax Implications" of the transaction and that paints a clear picture evidencing the parties' intent to be immediately taxed. (*Id.* at CG000041, CG000044.) Thus, the subsection cited by the Bergbauers does not contradict the parties' expressed desire for immediate taxability on the Consulting partners' received shares, but rather merely established the basis upon which gains and/or losses on future sales of Cap Gemini shares would be measured.

gain and, therefore, have this transaction closed" because "creeping vesting" carried too much risk (*Id.* at 149-151.)

Therefore, even if Robert Bergbauer did not immediately appreciate the operative tax language contained within the PID, after attending the March 7-8, 2000 meeting he was well aware that all parties to the agreement intended for the Consulting Partners to be immediately taxed on the entirety of their received Cap Gemini shares.

3. The Bergbauers' Actions After Closing Reflect Understanding of Immediate Taxability on The Shares in Their Entirety

Defendants' initial tax return provides very strong evidence that it was mutually understood that the transaction was fully and immediately taxable. As contemplated by the transaction documents, Defendants filed a joint return on or about July 13, 2001. This return reported $1,613,379 gross sale proceeds from the transaction (i.e. all 10,740 Cap Gemini shares) in accordance with the Form 1099-B issued to Bergbauer by Cap Gemini, leading to a total federal tax liability of $676,493. (*Id.* Ex. 13.) Notably, it was not until Cap Gemini stock plummeted to approximately $16 per share in 2002 that Defendants filed their amended return and now challenge the transaction's true tax implications. Indeed, prior to the precipitous drop in the share value, the Defendants, much like Cathy Culp and Cynthia

Fletcher and others similarly situated, showed no inclination to unilaterally alter the tax consequences of the transaction.

In sum, the extrinsic evidence in this case sheds light on the terms of the transaction documents, and this Court finds that based on the extrinsic evidence the parties' original intent was for the Consulting Partners to be immediately taxed on the entirety of the shares they received at the transaction's closing on May 23, 2000.

B. Economic Substance

"The second prong of the *General Insurance* test requires that the covenant bargained for have some independent value grounded in economic reality." *Wrangler Apparel Corp.*, 931 F. Supp. at 424 (citing *General Ins.*, 401 F.2d at 330). Thus, the transaction terms must contain some economic substance beyond the parties' subjective intent. The Fourth Circuit explained in *General Insurance* that a contract's terms must "have some independent basis in fact or some arguable relationship with business reality such that reasonable men, genuinely concerned with their economic future, might bargain for such an agreement." *General Ins.*, 401 F.2d at 330 (quoting *Schulz v. C.I.R.*, 294 F.2d 52, 55 (9th Cir. 1961)). In this case, all parties were engaged in arms-length negotiations in which each party bargained for and received real economic benefit. For instance, Cap Gemini ensured that there would not be an immediate sell-off, which would seriously harm

share value, by attaching restrictions and limitations preventing the immediate sale of shares given to the Consulting Partners. Likewise, the Consulting Partners believed that their newly acquired Cap Gemini shares would continue to increase in value and therefore sought immediate taxation on their total received shares to capitalize on anticipated future gains. Again, it was only after the stock price plummeted that the Bergbauers and many other similarly situated Consulting Partners sought to unilaterally recharacterize certain aspects of the transaction.[6]

In sum, full and immediate taxation was consciously chosen by sophisticated parties for real economic purposes. Thus, this Court is satisfied that the Fourth Circuit's two-pronged, "economic reality" test demonstrates that the IRS erroneously issued the Defendants a $276,510 tax refund that the Government may now recover.

6. As an additional matter, much like the taxpayers in Culp and Fletcher, Robert Bergbauer was an accomplished professional at the time of the transaction and "not an unsophisticated school[boy]." *Fletcher*, 2008 U.S. Dist. LEXIS 3555, *11. After agreeing twice (both at the March 7-8 meeting and in signing the CPTA) to the transaction's terms, Bergbauer received the tax consequences he sought.

Appendix B

CONCLUSION

For the foregoing reasons, the Defendants' Cross-Motion for Summary Judgment (Paper No. 33) is DENIED and the Government's Motion for Summary Judgment (Paper No. 28) is GRANTED. A separate Order and Judgment follows.

Dated: August 18, 2008

/s/
Richard D. Bennett
United States District Judge

APPENDIX C — ORDER AND JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MARYLAND DATED AUGUST 18, 2008 AND FILED AUGUST 19, 2008

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MARYLAND

Civil Action No. RDB-05-2132

UNITED STATES OF AMERICA

Plaintiff

v.

ROBERT L. BERGBAUER et ux.

Defendants

ORDER AND JUDGMENT

For the reasons stated in the foregoing Memorandum Opinion, it is this 18th day of August 2008, hereby ORDERED and ADJUDGED, that:

a. The Motion for Summary Judgment filed by the United States of America (Paper No. 28) is GRANTED;

b. The Motion for Summary Judgment filed by Robert and Marie Bergbauer (Paper No. 33) is DENIED;

c. Judgment is entered in favor of the United States of America and against Robert and Marie Bergbauer, in the amount of $276,510.00, plus statutory interest on that amount, accruing from August 4, 2003;

d. The Clerk of the Court transmit copies of this Order and Judgment and the accompanying Memorandum Opinion to counsel for the parties; and

e. The Clerk of the Court CLOSE THIS CASE.

/s/_____
Richard D. Bennett
United States District Judge

APPENDIX D — STATUTE AND REGULATIONS INVOLVED

26 U.S.C.S. § 451

§ 451. General rule for taxable year of inclusion.

(a) General rule. The amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period.

* * * *

26 C.F.R. § 1.451-1

§ 1.451-1 General rule for taxable year of inclusion.

(a) General rule. Gains, profits, and income are to be included in gross income for the taxable year in which they are actually or constructively received by the taxpayer unless includible for a different year in accordance with the taxpayer's method of accounting. Under an accrual method of accounting, income is includible in gross income when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy. Therefore, under such a method of accounting if, in the case of compensation for services, no determination can

be made as to the right to such compensation or the amount thereof until the services are completed, the amount of compensation is ordinarily income for the taxable year in which the determination can be made. Under the cash receipts and disbursements method of accounting, such an amount is includible in gross income when actually or constructively received. Where an amount of income is properly accrued on the basis of a reasonable estimate and the exact amount is subsequently determined, the difference, if any, shall be taken into account for the taxable year in which such determination is made. To the extent that income is attributable to the recovery of bad debts for accounts charged off in prior years, it is includible in the year of recovery in accordance with the taxpayer's method of accounting, regardless of the date when the amounts were charged off. For treatment of bad debts and bad debt recoveries, see sections 166 and 111 [26 USCS §§ 166 and 111] and the regulations thereunder For rules relating to the treatment of amounts received in crop shares, see section 61 [26 USCS § 61] and the regulations thereunder. For the year in which a partner must include his distributive share of partnership income, see section 706(a) [26 USCS § 706(a)] and paragraph (a) of § 1.706-1. If a taxpayer ascertains that an item should have been included in gross income in a prior taxable year, he should, if within the period of limitation, file an amended return and

pay any additional tax due. Similarly, if a taxpayer ascertains that an item was improperly included in gross income in a prior taxable year, he should, if within the period of limitation, file claim for credit or refund of any overpayment of tax arising therefrom.

* * * *

26 C.F.R. § 1.451-2

§ 1.451-2 Constructive receipt of income.

(a) General rule. Income although not actually reduced to a taxpayer's possession is constructively received by him in the taxable year during which it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions. Thus, if a corporation credits its employees with bonus stock, but the stock is not available to such employees until some future date, the mere crediting on the books of the corporation does not constitute receipt. In the case of interest, dividends, or other earnings (whether or not credited) payable in respect of any deposit or

account in a bank, building and loan association, savings and loan association, or similar institution, the following are not substantial limitations or restrictions on the taxpayer's control over the receipt of such earnings:

(1) A requirement that the deposit or account, and the earnings thereon, must be withdrawn in multiples of even amounts;

(2) The fact that the taxpayer would, by withdrawing the earnings during the taxable year, receive earnings that are not substantially less in comparison with the earnings for the corresponding period to which the taxpayer would be entitled had he left the account on deposit until a later date (for example, if an amount equal to three months' interest must be forfeited upon withdrawal or redemption before maturity of a one year or less certificate of deposit, time deposit, bonus plan, or other deposit arrangement then the earnings payable on premature withdrawal or redemption would be substantially less when compared with the earnings available at maturity);

(3) A requirement that the earnings may be withdrawn only upon a withdrawal of all or part of the deposit or account. However, the mere fact that such institutions may pay earnings on withdrawals, total or partial, made during the last three business days of any calendar month ending a regular quarterly or semiannual earnings period at the applicable rate calculated to the end of such calendar month shall not constitute constructive receipt of income by any depositor or account holder in any such institution who has not made a withdrawal during such period;

(4) A requirement that a notice of intention to withdraw must be given in advance of the withdrawal. In any case when the rate of earnings payable in respect of such a deposit or account depends on the amount of notice of intention to withdraw that is given, earnings at the maximum rate are constructively received during the taxable year regardless of how long the deposit or account was held during the year or whether, in fact, any notice of intention to withdraw is given during the year However, if in the taxable year of withdrawal the depositor or account

holder receives a lower rate of earnings because he failed to give the required notice of intention to withdraw, he shall be allowed an ordinary loss in such taxable year in an amount equal to the difference between the amount of earnings previously included in gross income and the amount of earnings actually received. See section 165 [26 USCS § 165] and the regulations thereunder.

* * * *

26 C.F.R. § 1.1060-1

§ 1.1060-1 Special allocation rules for certain asset acquisitions.

* * *

(e) Reporting requirements — (1) Applicable asset acquisitions — (i) In general. Unless otherwise excluded from this requirement by the Commissioner, the seller and the purchaser in an applicable asset acquisition each must report information concerning the amount of consideration in the transaction and its allocation among the assets transferred. They also must report information concerning subsequent adjustments to consideration.

(ii) Time and manner of reporting — (A) In general. The seller and the purchaser each must file asset acquisition statements on Form 8594, "Asset Allocation Statement," with their income tax returns or returns of income for the taxable year that includes the first date assets are sold pursuant to an applicable asset acquisition. This reporting requirement applies to all asset acquisitions described in this section. For reporting requirements relating to asset acquisitions occurring before March 16, 2001, as described in paragraph (a)(2) of this section, see the temporary regulations under section 1060 [26 USCS § 1060] in effect prior to March 16, 2001 (see 26 CFR part 1 revised April 1, 2000).

(B) Additional reporting requirement. When an increase or decrease in consideration is taken into account after the close of the first taxable year that includes the first date assets are sold in an applicable asset acquisition, the seller and the purchaser each must file a supplemental asset acquisition statement on Form 8594 with the income tax return or return of income for the taxable year in which the

increase (or decrease) is properly taken into account.

(C) Election described in § 1.338-6(c)(5)—(1) Availability. The election described in § 1.338-6(c)(5) is available in respect of an applicable asset acquisition provided that the requirements of that section are satisfied. Such election may be made by the seller, regardless of whether the purchaser also makes the election, and may be made by the purchaser, regardless of whether the seller also makes the election.

(2) Time and manner of making election. The election described in § 1.338-6(c)(5) is made by taking a position on a timely filed original tax return for the taxable year of the applicable asset acquisition that is consistent with having made the election.

(3) Irrevocability of election. The election described in § 1.338-6(c)(5) is irrevocable.

(4) Effective/applicability date. This paragraph (e)(1)(ii)(C) applies to applicable asset acquisitions occurring

on or after September 11, 2007. For applicable asset acquisitions occurring before September 11, 2007 and on or after September 15, 2004, see § 1.1060-1T as contained in 26 CFR Part 1 in effect on April 1, 2007. For applicable asset acquisitions occurring before September 15, 2004, see §§ 1.338-6 and 1.1060-1 as contained in 26 CFR Part 1 in effect on April 1, 2004.

(2) Transfers of interests in partnerships. For reporting requirements relating to the transfer of a partnership interest, see § 1.755-1(d).